CONGRESSIONAL BUDGET OFFICE
PAY-AS-YOU-GO ESTIMATE

January 16, 2002

H.R. 10
Railroad Retirement and Survivors' Improvement Act of 2001

As cleared by the Congress on December 11, 2001,
and signed by the President on December 21, 2001

SUMMARY

H.R. 10 (enacted as Public Law 107-90) makes several changes to the Railroad Retirement program. The act expands benefits for certain participants in the program and reduces the number of years of covered railroad service needed before a worker (and qualified spouse) can be vested in the system. The legislation also eliminates the Supplemental Annuity tax and lowers the payroll tax rate on railroad employers. Finally, the act creates a new National Railroad Retirement Investment Trust (NRRIT) and establishes a board to manage this fund. That board is authorized to invest the reserves of the Railroad Retirement System in private securities.

The Congressional Budget Office estimates that H.R. 10 will increase direct spending by $1.3 billion during the 2002-2006 period and by $3.9 billion over the 2002-2011 period. It will reduce revenues by $1.7 billion from 2002 through 2006 and by $4.0 billion over the 10-year period. The net effect of H.R. 10 will be to decrease the budget surplus by $3.0 billion from 2002 through 2006 and by $7.9 billion over the 2002-2011 period.

ESTIMATED COST TO THE FEDERAL GOVERNMENT

CBO's estimate of the impact of H.R. 10 on direct spending and revenues is shown in the following table. Only the estimated changes through fiscal year 2006 are counted for pay-as-you-go purposes. The costs of this legislation fall within budget function 600 (income security).

TABLE 1. ESTIMATED IMPACT OF H.R. 10 ON DIRECT SPENDING AND REVENUES

	By Fiscal Year, in Millions of Dollars										
	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
Changes in outlays	0	108	227	301	339	374	425	481	523	550	578
Changes in receipts	0	-118	-277	-410	-441	-443	-450	-454	-458	-458	-460

BASIS OF ESTIMATE

The Railroad Retirement system has two main components. Tier I of the system is financed by taxes on employers and employees equal to the Social Security payroll tax and provides qualified railroad retirees (and their qualified spouses, dependents, widows, or widowers) with benefits that are roughly equal to Social Security. Covered railroad workers and their employers pay the Tier I tax instead of the Social Security payroll tax, and most railroad retirees collect Tier I benefits instead of Social Security. Tier II of the system operates much like traditional multi-employer pension systems, with employers and employees contributing a certain percentage of pay toward the system to finance defined benefits to eligible railroad retirees (and qualified spouses, dependents, widows, or widowers) upon retirement. But while most multi-employer plans are run by a group of cooperating employers in the same industry, the federal government collects the Tier II payroll contributions and pays out the benefits.

H.R. 10 makes fundamental changes to the Railroad Retirement system by expanding certain retirement benefits, reducing payroll taxes, and authorizing a new government organization to invest funds credited to the Railroad Retirement Account in the private securities market. In addition, the act eliminates the separate account for supplemental benefits and pays those benefits directly from the NRRIT.

Direct Spending

Benefit Changes. CBO estimates that the four changes in Railroad Retirement benefits (described below and shown in Table 2) will increase spending by $0.1 billion in 2002 and by $3.9 billion over the 2002-2011 period. A fifth change, which will have no net budgetary effects, shifts payment of the Supplemental Annuity from its separate account to the National Railroad Retirement Investment Trust.

TABLE 2. ESTIMATED OUTLAY IMPACT OF BENEFIT CHANGES CONTAINED IN H.R. 10

	By Fiscal Year, in Millions of Dollars									
	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
Expansion of Widow/er Benefits	61	92	94	95	97	100	102	104	106	108
Reduction in Retirement Age	37	121	192	228	259	305	359	397	420	443
Reduction in Vesting Requirements	a	a	a	a	a	1	1	1	1	2
Repeal Ceiling on Railroad Retirement Benefits	11	14	15	16	18	19	20	22	24	26
Total Benefit Changes	108	227	301	339	374	425	481	523	550	578

Note: Components may not sum to totals because of rounding.

a = Less than $500,000.

Expansion of Widows' and Widowers' Benefits. Section 101 of the legislation increases Railroad Retirement annuities payable to certain widows and widowers of railroad employees. Under prior law, the Tier II component of a widow(er)'s Railroad Retirement annuity was generally equal to 50 percent of the Tier II benefit that was payable to the retired employee at the time of his or her death. Section 101 provides a guaranteed minimum benefit for widow(er)s based on 100 percent of the employee's Tier II annuity. This provision generally provides widow(er)s with the same Tier II benefits that were previously being paid to the now-deceased railroad retiree.

Section 101 applies to benefits paid in months beginning 30 days after the act was enacted. For widow(er)s whose benefits begin before that date, the guaranteed minimum will be based on the amount of the original annuity without adjustments for inflation.

According to the Railroad Retirement Board, this provision will initially affect approximately 50,000 widow(er)s currently collecting benefits. CBO estimates this provision will increase direct spending by $61 million in 2002 and by $957 million during the 2002-2011 period.

Reduction in Retirement Age. Section 102 provides for full retirement benefits at age 60 for railroad workers (and qualified spouses) who have at least 30 years of covered service. Under prior law, retirees with 30 years of service could begin collecting full Tier II benefits at age 60, but Tier I benefits were reduced if they filed before the age of 62. This legislation eliminates that reduction in Tier I benefits, which was enacted in the Railroad Retirement Solvency Act of 1983. Based on data provided by the Railroad Retirement Board, CBO estimates this provision will initially affect about 2,500 workers and increase direct spending by $37 million in 2002 and by $2.8 billion over the 2002-2011 period.

Reduction in Vesting Requirements. Section 103 reduces the number of years of covered service needed before workers (and qualified spouses) become vested in the Railroad Retirement System from 10 years to five years. The reduced vesting requirement only applies to qualified service performed after 1995. Employees who had fewer than 10 years of qualified railroad employment before 1996 would either have to meet the current 10-year vesting requirement or have five years of covered service after 1995 in order to be vested. Section 103 correspondingly reduces the vesting requirements for disability and survivor benefits.

Based on information provided by the Railroad Retirement Board, CBO estimates this proposal will have a negligible effect on direct spending through 2006, but will increase direct spending by $6 million during the 2007-2011 period.

Repeal of the Ceiling on Railroad Retirement Benefits. Prior law capped the total monthly benefits payable to a retiree and spouse under the Railroad Retirement system. This cap was calculated based on the employee's average monthly salary during the two years prior to retirement, or the worker's monthly Social Security earnings in the 10-year period prior to retirement. The maximum could not be more than the final average monthly compensation or less than $1,200. Section 104 repeals this limit, effective January 1, 2002. The Railroad Retirement Board indicates that about 2,000 employee annuitants and 12,000 spouse annuitants have been receiving reduced benefits because of the cap. CBO estimates that eliminating the maximum will increase direct spending by $11 million in 2002 and by $182 million from 2002 through 2011.

Revenues

H.R. 10 makes several changes to the payroll tax specified in the Railroad Retirement Act, and will result in estimated net revenue losses of $0.1 billion in 2002 and $4.0 billion over the 10-year period (see Table 3). Because reductions in employer-paid employment taxes are assumed to be passed through to workers as higher compensation, mostly in the form of wages, increased income and employee-paid payroll tax collections are assumed to offset 20 percent of the lost payroll tax revenues.

TABLE 3. ESTIMATED REVENUE IMPACT OF TAX PROVISIONS CONTAINED IN H.R. 10

	By Fiscal Year, in Millions of Dollars									
	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
Repeal of Supplemental Annuity Tax [a]	-59	-79	-81	-79	-77	-76	-75	-75	-74	-74
Adjustment in Tier II Tax Rate [a]	-59	-198	-329	-362	-366	-374	-379	-383	-384	-386
Total	-118	-277	-410	-441	-443	-450	-454	-458	-458	-460

a. Assumes that 20 percent of employer-paid payroll tax reductions are offset by additional income and employee-paid tax collections.

Supplemental Annuity Tax. Section 203 of the act repeals the Supplemental Annuity tax, which is currently levied on employers to pay for a third layer of benefits on top of Tier I and Tier II. Instead of being paid from a separate account, supplemental benefits will be paid directly from the Railroad Retirement Account. CBO estimates that this provision will reduce net revenue by $375 million over the 2002-2006 period and by $749 million over the 2002-2011 period.

Tier II Payroll Tax Rates. The act also lowers the Tier II tax rate on employers from 16.1 percent of payroll to 14.75 percent in calendar year 2002 and 14.2 percent in calendar year 2003. Thereafter, H.R. 10 links future Tier II tax rates to the financial condition of the NRRIT. Specifically, the act requires the Railroad Retirement Board to calculate the ratio of assets held in the trust fund (using the average balance in the fund over the previous 10 years) to the total Railroad Retirement benefits paid out in a given year (the account benefit or trust fund ratio). In 2004, CBO expects the account benefit ratio would be about 5.6, which would cause payroll tax rates to be set at 13.1 for employers and 4.9 for employees (which is the current rate for employees). CBO estimates that the Tier II tax rates will remain at that level through at least 2011 and that the changes in the tax rate will reduce revenue by $1.3 billion over the 2002-2006 period and $3.2 billion from 2002 through 2011.

Investment in Non-Treasury Securities.

Section 105 establishes a new entity, the National Railroad Retirement Investment Trust, which will be allowed to invest in non-Treasury securities, such as publicly traded stocks in private companies. The NRRIT will be funded by transferring assets from the Railroad Retirement Account, Social Security Equivalent Benefit Account, Supplemental Annuity

Account, and Duel Benefit Payments Account. Assets in these four funds totaled about $20 billion in December 2001 and previously had to consist solely of U.S. government securities.

Section 105(c) of the act specifies how investments by NRRIT in non-Treasury securities should be treated for budgetary purposes. The legislation states:

> "For all purposes of the Congressional Budget Act of 1974, the Balanced Budget and Emergency Deficit Control Act of 1985, and chapter 11 of title 13, United States Code, and notwithstanding section 20 of the Office of Management and Budget Circular A-11, the purchase or sale of non-Federal assets (other than gains or losses from such transactions) by the National Railroad Retirement Investment Trust shall be treated as a means of financing."

Under this provision, all purchases of non-Treasury securities by the NRRIT will not be counted as outlays for budgetary purposes, but rather as an exchange of assets of equal value. Conversely, any redemption of these non-federal assets will not be considered offsetting receipts. Instead, the federal government will record outlays or receipts only as the market value of the fund itself changes over time. In the event that the total value of the fund increases, the budget will show offsetting receipts equal to the change in its value. If the fund loses value, the budget will show outlays to reflect the change. The net gains or losses to the fund will appear in budget function 900 (net interest).

This estimate does not show any gains or losses to the fund over the 10-year period for two reasons. First, CBO and the Office of Management and Budget, following long-standing budget scoring precedents, do not show the effects of legislation on net interest payments. Second, although private securities may well yield higher gains, over the long term, than government securities, such investments carry much greater risk than government bonds, which are essentially risk-free. The difference between projected returns on government bonds and private securities can be seen as the cost investors are willing to pay in order to bear the additional risk of holding private securities instead of government bonds. Thus, adjusted for the additional risk associated with private securities, the expected returns on private securities are the same as those on government securities. Therefore, CBO projects returns to NRRIT's investments using a risk-free rate, equivalent to the government's borrowing rate, and thus shows no net budgetary changes as a result of those investments.

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